CONCLUSION

The petition for a writ of certiorari should be denied since no grounds of the character specified in Rule 19 of this Court appear.

Respectfully submitted,

Lawrence M. Cox

APPENDIX

Amended Complaint

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Civil Action No. 3050/65

LEO VINE,

Plaintiff,

—against—

BENEFICIAL FINANCE COMPANY, INC., CHARLES H. DOWD, STUART A. WIXSON, GEORGE J. SPRINGER, C. H. DONOHUE, and CROWN FINANCE COMPANY, INC.,

Defendants.

Plaintiff, for his Complaint, hereby alleges as follows:

1. (a) Plaintiff bases his claim herein upon Section 10b of the Securities and Exchange Act of 1934, 15 U.S.C. 78i(b) and Rule X-10b-5 promulgated thereunder by the Securities and Exchange Commission.

(b) The jurisdiction of the court herein is based upon Section 27 of the Securities and Exchange Act of 1934, 15 U.S.C. 78 aa.

2. (a) The Plaintiff is a citizen and resident of New York, and the Defendants Beneficial Finance Company, Inc. (hereinafter called "Beneficial") and Crown Finance Company, Inc. (hereinafter called "Crown") are corporations organized under the laws of Delaware with their principal offices in Wilmington, Delaware; the individual Defendants are, to Plaintiff's information and belief, regularly employed at the offices of Beneficial and Crown in

Delaware, but Plaintiff does not know the several states in which such individuals now reside.

(b) The matter in controversy herein, exclusive of interest and costs, exceeds the sum of $10,000, and Plaintiff submits the matters hereinafter set forth to the jurisdiction of this court on the additional basis of diversity of citizenship, pursuant to 28 U.S.C. 1332.

3. (a) The Plaintiff is the record owner of 100 shares of the Class A Common Stock of Crown, (hereinafter called the "Class A stock"), and owned such shares long prior to and at the time of the wrongs complained of herein.

(b) The Plaintiff brings this action derivatively on behalf of Crown and all of its Class A stockholders existing at the time of the wrongs complained of herein, and Plaintiff is a proper representative of such class.

(c) This action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

4. The Defendant Beneficial acting in concert with the individual Defendants, who are officers and directors of Crown and who were the principal holders of the Class B Common Stock of Crown (hereinafter called the "Class B stock"), undertook a fraudulent scheme directed against the corporation and the Class A stockholders of Crown. The scheme was to appropriate to the holders of the Class B stock of Crown a cash sum of approximately $900,000 which would otherwise have been paid to the Class A stockholders of Crown, and to merge Crown into Beneficial for a total cash consideration of at least $800,000 less than the fair market value of Crown as a going business. Such scheme and conspiracy resulting in the unjust en-

richment of the Class B stockholders and Defendant Beneficial at the expense of the Class A stockholders is hereinafter described in detail.

5. (a) Crown is a Delaware corporation which has two classes of common stock. The Class A stock and the Class B stock have equal voting rights on all matters placed before stockholders except that the Class A stock has the right to designate one-third of the directors of the corporation, and the holders of the Class B stock have the right to designate two-thirds of the directors of the corporation. With respect to a merger, sale of assets or changes in the corporate charter, the holders of both classes of stock have the same voting rights share for share.

(b) The rights of the Class A stockholders and the Class B stockholders in the liquidation of the corporation were that each share of Class B stock would be equal to one-tenth of a share of Class A stock, and thus it took ten shares of Class B stock to have an equivalent claim on assets in liquidation to that of one share of Class A stock. In addition, Class A stock as a class has the right to receive 80% of the total sum set aside for payment of cash dividends at any time, and the remaining 20% of such sum is payable to Class B stock as a class.

(c) During all times hereinafter mentioned, Crown had 624,870 shares of Class A stock outstanding, and 46,500 shares of Class B stock outstanding.

6. (a) During the Spring and Summer of 1963, Defendant Beneficial, which is a very large corporation listed on the New York Stock Exchange, entered into negotiations for acquisition of Crown, a small company with limited over-the-counter trading in its stock, with a view

towards buying the business of Crown as a going enterprise and merging such business into Beneficial. Both Beneficial and Crown are in the same business, which is the operation of small loan and personal finance offices, and the location of the Defendant Crown's finance offices in New York, Connecticut, Massachusetts and New Jersey, constituted an attractive merger possibility for the Defendant Beneficial.

(b) In connection with negotiations for the acquisition of the business of Crown, Beneficial, to Plaintiff's information and belief, determined that it would like to acquire Crown as a going business and merge it into Beneficial at a cash cost equal to the approximate amount of its book net worth. The book net worth of Crown as at June 30, 1963 was $1,681,601, without giving any value to its good will as a going enterprise, in business for over 25 years.

(c) Beneficial is a corporation with over one billion dollars in assets, and to Plaintiff's information and belief, intended to buy Crown only if it could be merged into Beneficial and operated as part of Beneficial.

7. The officers and directors of Crown, who owned virtually all of its Class B stock, i.e. the controlling bloc of stock solely by reason of their ability to designate a majority of the board of directors, realized that Beneficial was willing to pay at least the $1,700,000 book net worth of Crown, to acquire its business. These holders of Class B stock therefore embarked upon a scheme and conspiracy with Beneficial, to divert this corporate opportunity for sale of the business and merger into Beneficial to themselves, by selling Crown at a price lower than its fair market value, and appropriating the bulk of the cash consideration to the holders of the Class B

stock, leaving a minimum amount for payment to the holders of the Class A stock.

8. The individual Defendants, as controlling officers and directors held 42,916 shares of the Class B stock and approximately 1,187 shares of the Class A stock, and were minority shareholders as a result. The aggregate claim on the book net worth of Crown of the 46,500 shares held by the Class B stockholders as at June 30, 1963, consisted of approximately $12,500. The aggregate claim on the book net worth of the 624,870 shares held by the Class A stockholders on June 30, 1963 consisted of approximately $1,670,000.

(a) Had Beneficial pursued its merger plans directly, and (i) offered to merge Crown into Beneficial, giving Crown's shareholders cash in exchange for their stock, or (ii) offered to buy all of Crown's assets for cash, followed by Crown's liquidation into the hands of its shareholders, the Class A stockholders would, in either case, have voted share and share alike with the Class B stockholders on these corporate transactions. The overwhelming voting superiority of the Class A shares would have prevented any merger or sale of assets which gave grossly disportionate proceeds to the holders of Class B shares. A merger or sale of assets required approval of 66⅔% of all stockholders, and there were 624,870 Class A shares and 46,500 Class B shares which would have voted share for share alike. In a merger or sale of assets recommended by unselfish directors properly pursuing the interests of the corporation, and voted on by all shareholders, the Class A shareholders would necessarily have received approximately $1,670,000 and the Class B shareholders some $12,500. Moreover, in a good faith merger or sale of assets, the buyer of

Crown would have been required to pay something more than merely the book net worth of this well established loan company.

(b) The holders of the Class B stock of Crown conducted the initial discussions and controlled all of the negotiations with Beneficial, by reason of their fiduciary position as directors and officers of Crown. Using this fiduciary position in the negotiations, these holders of Class B stock, to Plaintiff's information and belief, diverted the corporation's opportunity to merge or sell its assets and entered into a conspiracy with Beneficial to shape the transaction in such a way that the holders of the Class B stock were paid the sum of approximately $700,000 for a purchase of their shares, plus an aggregate of some $200,000 in benefits under employment and consulting agreements, instead of the $12,500 to which they were entitled in the merger. As part of this scheme, the holders of the Class A stock were offered and paid, an aggregate of approximately $800,000 for their stock as a class, instead of some $1,670,000 to which they were entitled in the merger.

(c) Defendant Beneficial knowingly entered into the aforesaid conspiracy with the Class B stockholders of Crown on or about August 5, 1963, with the purpose and intention of defrauding the holders of the Class A stock of Crown out of their proper participation in the proceeds of the sale of its business and merger into Beneficial. Beneficial's motive, to Plaintiff's information and belief, was to keep the overall cash cost of the merger down by grossly overpaying one class of stock which had few shares outstanding and grossly underpaying the other class of stock which had many shares outstanding. Such merger is now in the process of completion on a statutory basis, and as a result of this conspiracy, Beneficial owns

Crown for at least $300,000 less than its true value as a going business.

9. (a) In connection with the aforesaid transaction, Beneficial made an offer to purchase all of the shares of the Class A stock of Crown, which had not previously been acquired from the controlling group of shareholders who held the Class B shares of Crown. Such offer was made in writing by Beneficial commencing August 19, 1963, for the purchase of 521,146 shares of Class A stock of Crown for $1.25 per share, and such offer was increased to $2.50 per share pursuant to an offer sent out to all remaining Class A stockholders of Crown on January 18, 1965.

(b) The overall scheme of purchase and merger herein alleged, which included several offers made by Beneficial which were accepted by several Class A stockholders of Crown, who did not know the true facts, and were not accepted by other Class A stockholders of Crown, constituted, directly or indirectly, (1) devices, schemes or artifices to defraud, (2) the making of untrue statements of material facts and omissions to state material facts necessary to make the said Defendants' statements, in the light in which they were made, not misleading, and (3) engaging in acts, practices and a course of business which operated as a fraud and deceit upon the Class A stockholders of Crown, in connection with the offer to purchase and the purchase of their Class A stock from them. Among other things such offers, as part of the overall scheme, contained materially misleading financial information on Crown, omitted material information which would have apprised Class A shareholders of their rights in the acquisition of their company and were an integral part of the scheme of fraudulent

acquisition and merger being practiced on all Class A stockholders by Beneficial and the Class B stockholders.

10. The Defendants have used means and instrumentalities of interstate commerce and of the mails in connection with the foregoing fraudulent acts which are violations of the statute of the United States set forth in paragraph 1 of this Complaint, and also constitute fraud and deceit under the laws of Delaware and New York.

11. The aforesaid offer to the Class A stockholders of Crown was made in writing by Beneficial, at $1.25 per share after Beneficial had agreed to purchase the stock of the Class B stockholders of Crown for approximately $15.00 per share. In terms of the relative rights of the two classes of stock, the Class B stockholders were paid a premium of at least 1200% for the right to designate a majority of the directors which was appurtenant to their shares. Class B shareholders were paid a total of $695,000 for the Class B shares which had a claim against the assets of Crown in a merger or liquidation of about $12,500. In addition the holders of Class B shares received lucrative employment and consulting agreements from Beneficial and Crown aggregating to some $200,000 as additional compensation. Defendant Beneficial received at least $300,000 in tangible assets without paying for them, and to Plaintiff's information and belief, the going business value of Crown was worth at least $500,000 which was not paid for by Beneficial.

12. Since the acquisition of Crown by Beneficial, Beneficial has embarked on a course of conduct to further derogate the value of the Class A stock of Crown, and further attenuate the rights of the holders thereof, including but not limited to, the following acts:

(a) Beneficial and the individual Defendants have for no valid business reason caused Crown to refrain from paying any dividends, notwithstanding a continuous payment of dividends by Crown from 1951 through 1962, and no dividends have been paid since Beneficial acquired Crown.

(b) Beneficial has tampered with the methods of accounting previously applied on a consistent basis by Crown by fictitiously increasing reserves for bad accounts and making other accounting entries which make it appear that Crown is losing substantial sums of money from operations since its acquisition by Beneficial, and is therefore a non-remunerative investment for its Class A stockholders. In fact, the business of Crown has continued virtually unchanged since its acquisition by Beneficial, except for profitable sell-offs of several branch offices at nearly $300,000 more than the book value paid for these tangible assets by Beneficial.

(c) Beneficial has, to Plaintiff's information and belief, caused Crown to enter into a Management Agreement with a subsidiary of Beneficial, Beneficial Management Corporation, which sells administrative and legal services to Crown at prices which further cause a diminution in the annual earnings of Crown, and are duplicative of services being rendered to Crown by its existing officers.

(d) Beneficial has continued to compensate the holders of Class B stock which joined with it in this conspiracy, by keeping them on employment and consulting agreements at substantial salaries with little or no services performed to Crown.

(e) Beneficial is currently engaged in merging Crown into Beneficial on a basis which pays the minority stockholders of Crown $3.29 in cash per share, with no

further interest in the corporation or the successor corporation, Beneficial, after the merger, thus completing the fraudulent scheme for exclusion of the Class A stockholders of Crown from participation in the going business value of their Company.

13. (a) At the initiation of the fraudulent scheme, Beneficial held out to the Class A stockholders in a written offer to purchase that their stock was reasonably worth $1.25 per share and should be sold for that price, and two years later, after showing losses and withholding dividends, Beneficial has stated to the Class A stockholders of Crown that in its opinion, their stock is now worth nearly 300% more, $3.29 per share, in the merger, placing a value of over $2,000,000 on the net tangible equity of Crown, without giving any value to good will.

(b) In truth and in fact, the substantive merger was completed by the fraudulent scheme occurring in August, 1963, and the statutory merger where the fair market value of the 624,687 shares of Class A stock would have been recognized was intentionally delayed until most of the Class A stockholders had been fraudulently induced to sell their stock. The Class A stockholders who sold out were defrauded, the Class A stockholders who remained were defrauded and the Class A stockholders who exercised their appraisal rights in the merger now in process have also been defrauded by this single scheme.

14. By reason of the aforesaid conspiracy, and the steps taken in the pursuance thereof, all of the Defendants are in pari delicto with each other, and are jointly and severally liable, responsible and accountable to the Class A stockholders of Crown and to such corporation for the acts and harm which has occurred to date. All of the aforesaid corporate acts and transactions by the Defend-

ants arising out of their conspiracy and plan to defraud the Class A stockholders of Crown are illegal and void under the laws of Delaware, New York and the United States.

15. This action is instituted by the Plaintiff stockholder on behalf of the corporation Crown because it would be futile to request the President of such corporation to institute said action, due to the domination and control exercised over it by the Defendant Beneficial. Corporate steps now in process by the Defendants to merge Crown into Beneficial and pay remaining Class A stockholders in cash are part of the plan and conspiracy complained of herein, and the only surviving corporate entity will be or may now be the wrongdoer, Defendant Beneficial.

16. Plaintiff has incurred and will continue to incur substantial attorneys' fees and expenses in the bringing of this action on behalf of himself and all other stockholders of Crown similarly situated.

WHEREFORE, Plaintiff demands the following:

(1) Judgment against Beneficial and the individual Defendants for $1,700,000 damages in favor of Crown, plus whatever additional sum Crown's assets were in fact worth when control of them was acquired by Beneficial, with interest from July 29, 1963 and punitive damages in the sum of $2,000,000 together with the amount of any additional damages suffered by Crown and its Class A stockholders prior to the satisfaction of any judgment entered herein, all such monies to be set aside and paid pro rata to all holders of Crown's Class A stock, except for those holders who participated in the wrongs to the corporation complained of herein,

(2) An order awarding Plaintiff his reasonable attorneys' fees herein together with costs and disbursements in this action, and

(3) An order awarding Plaintiff such other and further relief as shall be just and proper in the premises.

Dated: New York, New York
November 4, 1965

BERMAN & POWERS
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By /S/ LAWRENCE M. POWERS
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(Verified)

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION BELOW

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 30,500

LEO VINE,

Plaintiff-Appellant,

v.

BENEFICIAL FINANCE COMPANY, INC.,

Defendant-Appellee,

and

CHARLES H. DOWD, STUART A. WIXSON, GEORGE J. SPRINGER, C. H. DONOHUE and CROWN FINANCE COMPANY, INC.,

Defendants.

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

On October 18, 1966, this Court requested the Securities and Exchange Commission ("Commission") to file a brief in this appeal to express its views on the interpretation of Rule 10b-5 under the Securities Exchange Act of 1934 at issue.

Statement of the Case

Appellant, the owner of 100 shares of Class A common stock of Crown Finance Company, Inc. ("Crown"), a Delaware corporation, brought this action for damages based upon Section 10(b) of the Securities Exchange Act

of 1934 ("Securities Exchange Act"), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5. The amended complaint alleges that Beneficial Finance Company, Inc. ("Beneficial") and the individual defendants, who are former directors of Crown, entered into a fraudulent scheme to merge Crown into Beneficial. The pertinent allegations of the amended complaint may be summarized as follows:

Prior to the merger Crown had outstanding two classes of stock, Class A and Class B. Each class had equal voting rights, except that the holders of Class B stock as a class were entitled to elect two-thirds of the members of the board of directors (14a).[1] The Class B stock was held by the directors of Crown (15a). The Class A stock was outstanding in the hands of public shareholders. In 1963 Beneficial and the directors of Crown who owned the Class B stock allegedly entered into a fraudulent scheme for the merger of Crown into Beneficial whereby Beneficial would acquire the assets of Crown for a total consideration less than the fair market value of Crown as a going business (13a, 14a). As a result of this scheme, the Class B stockholders who conspired with Beneficial received substantial cash consideration for their shares while the public Class A stockholders received insufficient consideration for their shares (15a, 16a). The alleged scheme involved three steps:

(1) Beneficial purchased the Crown Class B stock from the directors of Crown for approximately $15 per share for a total consideration of $900,000 (17a, 19a).

(2) Beneficial made a tender offer to Class A shareholders at $1.25 per share, which was later increased to $2.50 per share in a subsequent tender offer, and purchased sufficient shares to acquire 95% of the Class A

[1] "a" refers to the appendix to appellant's brief [in the Court of Appeals].

stock for a total of $800,000 (18a). "Among other things," it is alleged, "such offers, as part of the overall scheme, contained materially misleading financial information on Crown, omitted material information which would have apprised Class A shareholders of their rights in the acquisition of their company and were an integral part of the scheme of fraudulent acquisition and merger being practiced on all Class A stockholders by Beneficial and the Class B stockholders" (18a-19a).

(3) Beneficial caused a short form merger of Crown with a wholly-owned New York subsidiary of Beneficial under Section 905 of the New York Business Corporation Law, pursuant to a plan of merger which provided for payment to minority shareholders for their stock on the basis of $3.29 per share in cash (17a, 20a-21a).[2]

As a result of the alleged fraudulent scheme of merger, Beneficial was able to acquire Crown for a total consideration of $1,700,000, at least $800,000 below the worth of the company as a going concern (13a).

On the motion of Beneficial, the court below dismissed the amended complaint holding, *inter alia,* that it failed to state a cause of action under Section 10(b) and Rule 10b-5 thereunder since it failed to show that appellant was a seller of securities.

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[2] Section 905 of the New York Business Corporation Law provides that a corporation owning at least 95% of the outstanding stock of another corporation may merge such other corporation into itself without the authorization of the shareholders of such other corporation upon approval of a plan of merger by the board of directors of the surviving corporation, a copy of which must be provided to all shareholders of the subsidiary corporation, and filing of articles of merger with the state. A short form merger of a domestic and foreign corporation is permitted under Section 907 of the New York Business Corporation law if such form of merger is also permitted under the laws of the state of foreign incorporation. A short form merger is permitted under 8 Del. Code § 253.

ARGUMENT

Purchases through False Representations by One Corporation of Sufficient Shares of Another Corporation to Permit the Former to Effectuate a Short Form Merger with the Latter, So That the Remaining Stockholders of the Latter Cease to Have a Stock Interest in Either Corporation, Created a Cause of Action on Their Behalf under Section 10(b) of the Securities Exchange Act and Rule 10b-5 for Damages Caused Thereby.

It is the Commission's view that any damages resulting to appellant from the series of transactions alleged should be recoverable under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder on the basis of either of two theories: (1) such damages flow directly from Beneficial's alleged violations of Rule 10b-5 in connection with its purchases of stock from Class A stockholders of Crown pursuant to its tender offers and (2) the merger, whereby appellant's stock ceased to constitute an interest in Crown as a viable corporation, itself resulted in a purchase of that stock within the meaning of Rule 10b-5 brought about by Beneficial's alleged fraudulent scheme.

1. It is alleged that the purchases of Crown stock pursuant to the tender offers were effected by fraudulent misrepresentations—a clear violation of Rule 10b-5. Since these purchases enabled Beneficial to meet the conditions for the short form merger, which appellant contends resulted in injury to him, on proof of these allegations appellant should be able to recover his damages from Beneficial. That he may not have been misled by the false representations made by Beneficial in connection with its tender offers is no reason for precluding his recovery for injury he has sustained as a result thereof. The situation is not comparable to *List* v. *Fashion Park, Inc.*, 340 F.2d 457 (C.A. 2, 1965), *certiorari denied*, 382 U.S. 811 (1965),

where this Court held that the plaintiff was required to prove reliance on the misleading non-disclosures because in that action there could have been no injury in the absence of such reliance.[3] Nor is the situation here comparable to *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (C.A. 2, 1952), *certiorari denied*, 343 U.S. 956 (1952), or to *O'Neill* v. *Maytag*, 339 F.2d 764 (C.A. 2, 1964). In those cases it was held that there was no deception practiced upon the parties to the securities transactions and that, therefore, there was no violation of Rule 10b-5. In *Maytag* there was no deception on the decision-making group, here there was. The fraud in *Maytag* was on the corporation but the corporation was not deceived. Here the fraud was on the Class A shareholders who sold pursuant to the tenders and they were allegedly deceived.

The purpose of Section 10(b) of the Securities Exchange Act and of Rule 10b-5 is to protect security holders; appellant, as a stockholder of Crown, is entitled to the protections therein. The fact that damages are sought not by a selling stockholder but by another stockholder of the same company, claiming damages flowing from a loss of value in his stock by reason of the violation, should be no ground for failure to apply the general rule that persons for whose benefit the statute was enacted may sue for damages caused them by its violation.[4]

The Supreme Court has held that a stockholder may bring a cause of action based on comparable provisions of the Commission's proxy rules, even though the stockholder was not himself misled by the false statements in

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[3] Of course, appellant's action here would fall if it should be found that those who sold pursuant to the tender offers would have done so despite the allegedly misleading representations or omissions.

[4] *Borak* v. *J. I. Case Co.*, 377 U.S. 426 (1964); *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (C.A. 2, 1951).

the proxy soliciting material that constituted the alleged violation. *Borak* v. *J. I. Case Co.*, 377 U.S. 425 (1964). In that case, as in this, the plaintiff alleged injury by reason of a merger brought about through use of misleading statements in violation of the Securities Exchange Act and the Commission's rules thereunder. The court made clear that if the plaintiff should be able to prove a "causal relationship of the proxy material and the merger", *Id* at 436, and that the merger resulted from fraud or was non-beneficial, plaintiff was entitled to relief. The court also held that the right of action existed as to "both derivative and direct causes." *Ibid.* Similarly, here the complaint seeks relief both derivatively and directly.

2. In any event, the merger by which plaintiff ceased to have rights as a stockholder of Crown involved a purchase and sale of securities, as those terms are broadly defined in the Securities Exchange Act, and was brought about by Beneficial's alleged fraudulent scheme. Section 3(a)(14) of the Securities Exchange Act, 15 U.S.C. 78c(a)(14), provides that a "sale" includes "any contract to sell or otherwise dispose of" securities and Section 3(a)(13), 15 U.S.C. 78c(a)(13), provides that a "purchase" includes "any contract to buy, purchase, or otherwise acquire" securities. Congress thereby made clear that these concepts embrace transactions beyond the limitations ordinarily applicable under the commercial law of sales in order to effectuate a primary purpose of the Act expressed in Section 2, 15 U.S.C. 78b, to make the "regulation and control" of transactions in securities "reasonably complete and effective."

The disposition of the outstanding shares of Crown held by the minority shareholders pursuant to the short form merger of Crown into Beneficial falls within these definitions since appellant's rights as a shareholder of Crown

were extinguished by the merger of Crown into Beneficial.[5] When appellant acquired his Crown stock he agreed by virtue of the applicable provisions of Delaware corporation law that if the statutory conditions precedent to effect a short form merger should be satisfied, the surviving corporation would have, in effect, an option to purchase his shares at a price and upon terms and conditions to be determined by the plan of merger.[6] The plan of merger was, in effect, the exercise of that option by Beneficial and as such resulted in a purchase of securities within the meaning of the Securities Exchange Act.[7] Since there was nothing involuntary about Beneficial's determination, there is no merit to its position (Brief p. 10) that the involuntary nature of the short form merger excludes it from Rule 10b-5.

It was held in *Voege* v. *American Sumatra Tobacco Corporation,* 241 F. Supp. 369 (D. Del., 1965), that a short form merger under Delaware law involved a sale within the meaning of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. "Any other view of the

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[5] As a result of the merger appellant had only the right to receive cash for his shares under the terms of the plan of merger or to seek to establish his rights as a dissenter in an appraisal proceeding under state law. We do not reach the question whether appellant would have had an adequate remedy in an appraisal proceeding. See *Borak* v. *J. I. Case Co., supra.,* 377 U.S. at 434.

[6] *See Voege* v. *American Sumatra Tobacco Corporation,* 241 F. Supp. 369, 373-74 (D. Del., 1965) and cases cited.

[7] Although this Court phrased its request for the Commission's participation in this appeal with respect to the question whether there was a "sale" of appellant's securities pursuant to the short form merger, the alleged fraud would appear to be in the "purchase" thereof, as these terms are generally used in the antifraud provisions of the securities laws. Thus, Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), which covers fraud only in the "offer or sale" of securities relates to fraud only by the seller of securities, while Rule 10b-5 which includes fraud in connection with the "purchase" as well as the "sale" of securities includes fraud by the purchaser of securities.

transaction," the court noted, "would defeat the purpose of Rule 10b-5 . . ." *Id.* at 374.[8] This is in accord with one of the broad purposes of the Securities Exchange Act "to keep the channels of interstate commerce, the mail[s], and national security exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation." *Hooper* v. *Mountain States Securities Corporation,* 282 F.2d 195, 202 (C.A. 5, 1960), *certiorari denied* 365 U.S. 814 (1961). This purpose would be thwarted if the investor protections afforded by Section 10(b) and Rule 10b-5 could be avoided by the formalistic view that there was no purchase of appellant's securities pursuant to the the merger of Crown into Beneficial's subsidiary. The Supreme Court has held that the securities laws must be construed "not technically and restrictively, but flexibly to effectuate . . . [their] remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 195 (1963). See also *Securities and Exchange Commission* v. *W. J. Howey Co.,* 328 U.S. 293, 301 (1946). And see *Errion* v. *Connell,* 236 F.2d 447 (C.A. 9, 1956), where the court said that the Securities Exchange Act created a federal remedy for one who has been defrauded of his securities.

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[8] Other cases likewise have held that transactions in mergers are purchases or sales of securities under Rule 10b-5. See *Simon* v. *New Haven Board & Carton Co.,* 250 F. Supp. 297 (D. Conn. 1966); *Securities and Exchange Commission* v. *Anaconda Lead & Silver Company,* (D. Col. No. 6819, July 11, 1961); *H. L. Green Company* v. *Childree,* 185 F. Supp. 95 (S.D.N.Y. 1960). But see, *Dasho* v. *The Susquehanna Corporation* (N.D. Ill. No. 65C1757, April 15, 1966, *rehearing denied,* June 28, 1966), *appeal pending*; See also *Blau* v. *Hodkinson,* 100 F. Supp. 361 (S.D.N.Y. 1951), where it was held that the acquisition by corporate insiders of stock pursuant to a plan of reorganization was a sufficient contract to acquire securities for purposes of recovering short swing profits under Section 16(b) of the Securities Exchange Act, 15 U.S.C. 78n(b). But see, *Roberts* v. *Eaton,* 212 F.2d 82 (C.A. 2, 1954), *certiorari denied,* 348 U.S. 827 (1954), where it was held that a reclassification of the outstanding stock of a corporation which could not lend itself to speculation encompassed by Section 16(b) was therefore not a "purchase."

The short form merger was only the last step in, and an integral part of, the allegedly fraudulent scheme to acquire the assets of Crown for less than their fair value. In this regard, the Supreme Court pointed out with respect to fraud in proxy solicitations that:

> "The injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done to the corporation, rather than from the damage inflicted directly upon the stockholder. The damage suffered results not from the deceit practiced on him alone but rather from the deceit practiced on the stockholders as a group." *Borak* v. *J. I. Case Co., supra.*, 377 U.S. at 432.

CONCLUSION

For the foregoing reasons the Commission urges that this Court hold that the amended complaint states a cause of action under Section 10(b) and Rule 10b-5 thereunder.

Respectfully submitted,

PHILIP A. LOOMIS, JR.
General Counsel

DAVID FERBER
Solicitor

ROY NERENBERG
Attorney

Securities and Exchange Commission
Washington, D. C. 20549

November 1966.

Decision of District Court Filed February 23, 1966

#32090

Motion #50

1/25/66

[SAME TITLE]

APPEARANCES:

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For defendant Beneficial Finance Company, Inc.:

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By WILKIE BUSHBY, ESQ.

OPINION

BONSAL, *D.J.*

Defendant Beneficial Finance Company, Inc. (Beneficial), a Delaware corporation, moves pursuant to Rule 12(b) of the Federal Rules of Civil Procedure to dismiss the complaint in this action for lack of jurisdiction and failure to state a claim on which relief can be granted.

Plaintiff, a resident of New York, record holder of 100 shares of Class A common stock of Crown Finance Company, Inc. (Crown), a Delaware corporation, instituted this action to recover damages on behalf of himself and the other Class A stockholders similarly situated, arising from an allegedly fraudulent scheme of merger under-

taken by the defendant Beneficial and the former directors of Crown. Plaintiff bases his claim on Section 10(b) of the Securities and Exchange Act of 1934 (15 U.S.C. §78j) and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission, and on the common law, and asserts jurisdiction under Section 27 of the Securities and Exchange Act of 1934 (15 U.S.C. §78aa) and on diversity of citizenship (28 U.S.C. §1332).

For the purposes of this motion to dismiss, the factual allegations of the complaint are accepted as true. *Arfons* v. *E. I. Du Pont de Nemours & Co.*, 261 F.2d 434 (2d Cir. 1958); *Cochran* v. *Channing Corp.*, 211 F.Supp. 239 (S.D. N.Y. 1962); 2 Moore, *Federal Practice*, ¶12.08, at 2244-45 (2d ed. 1964).

While the amended complaint (complaint) is diffuse and certainly not a model of short and concise pleading (Rule 8, Fed. R. Civ. P.), the following facts appear to be alleged:

Crown was a relatively small, publicly owned finance company. It had outstanding two classes of stock, Class A and Class B, with equal voting rights except that the holders of the Class B stock were entitled as a class to elect two-thirds of the members of the Board of Directors. Forty-six thousand, five hundred shares of Class B stock were outstanding, which were held by the directors of Crown, and 624,870 shares of Class A stock were outstanding in the hands of the public. It is alleged that the holders of the Class A stock were entitled to 80% of any dividends, and upon liquidation of Crown, would receive approximately 99% of the assets of the company.

The complaint alleges that in the spring of 1963 Beneficial decided to acquire Crown and to merge it into Beneficial's national network of personal loan offices. To achieve this end, it is alleged that Beneficial approached the directors of Crown, who were the holders of the Class B stock, and together they devised a fraudulent scheme to

defeat the rights of the holders of the Class A stock. The alleged fraudulent scheme involved three steps: (1) a purchase by Beneficial of the Class B stock from the directors of Crown; (2) a public offer or tender by Beneficial to the holders of the Class A stock to acquire 95% of the total outstanding shares of Crown; and (3) a short form merger of Crown into a wholly-owned New York subsidiary of Beneficial which would result in the acquisition of the remaining shares of Class A stock.

Acting pursuant to this allegedly fraudulent scheme, the complaint alleges that Beneficial purchased the Class B stock from the directors of Crown for $900,000. Thereafter, Beneficial offered to purchase Class A shares and purchased sufficient shares to give them 95% of the Class A stock for an outlay of $800,000. Thereafter, on September 30, 1965, Crown was merged into a wholly-owned subsidiary of Beneficial in New York under Section 905 of the New York Business Corporation Law (short form merger). The complaint alleges that the total of $1,700,000 paid to the Class B and Class A stockholders was at least $800,000 below the true worth of Crown as a going concern. The complaint further alleges that if Beneficial had acquired the assets of Crown, the Class B stock would have received less than 1% of the purchase price in a subsequent liquidation of Crown, whereas under the allegedly fraudulent scheme they received approximately 50%.

The complaint charges that in its public offer to purchase Class A stock, Beneficial made misleading statements as to the financial condition of Crown and omitted to state material facts as to the rights of the Class A stock in violation of the Securities and Exchange Act (Section 10(b) and Rule 10b-5). The complaint asserts a "spurious" class action on behalf of the plaintiff and all other Class A shareholders by reason of this alleged fraudulent scheme, based both upon the Securities and Exchange Act and the common law.

Defendant Beneficial contends that plaintiff does not come within the ambit of the Securities and Exchange Act, Section 10(b) and Rule 10b-5, since he did not accept Beneficial's offer for his Class A stock and he has not surrendered his stock certificates under the short form merger. Therefore, if a fraud was committed with respect to the plaintiff, it was not in connection with the purchase or sale of any security. Accordingly, argues Beneficial, the plaintiff was not a defrauded seller under Section 10(b). *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461, 464 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952); *New Park Mining Co.* v. *Cranmer*, 225 F.Supp. 261, 266 (S.D.N.Y. 1963).

The courts have liberally construed the phrase "in connection with the purchase or sale of any security," *Cooper* v. *North Jersey Trust Co.*, 226 F.Supp. 972 (S.D.N.Y. 1964); *New Park Mining Co.* v. *Cranmer, supra; Pettit* v. *American Stock Exchange*, 217 F.Supp. 21 (S.D.N.Y. 1963); *Stockwell* v. *Reynolds & Co.*, S.D.N.Y., Sept. 22, 1965, CCH Fed. Sec. L. Rep. ¶91,579, but in each of these cases the plaintiff was a seller of securities and alleged that the fraud had induced the sale. Accepting the complaint as true, it would appear that the Class A stockholders who sold to Beneficial may have a cause of action against it, but this does not aid the plaintiff. As stated in *Kremer* v. *Selheimer*, 215 F.Supp. 549 (E.D.Pa. 1963): "It is not sufficient to show that a third person, in a separate transaction, was defrauded."

Plaintiff, however, relies on *Voege* v. *American Sumatra Tobacco Corp.*, 241 F.Supp. 369 (D.Del. 1965). In that case the court upheld a complaint as stating a cause of action under Section 10(b) of the Securities and Exchange Act which alleged the fraudulent acquisition of stock followed by a Delaware short form merger even though plaintiff did not sell his stock. But *Voege* involved Delaware law, while this action involves New

York law. Both Delaware and New York provide the method by which non-assenting stockholders may obtain an appraisal of their stock, but the New York law contains a saving clause not present in the Delaware statute. Section 623(k) of the New York Business Corporation Law provides that the appraisal proceeding "shall not exclude the right of such shareholder to bring or maintain an appropriate action to obtain relief on the ground that such corporate action will be or is unlawful or fraudulent as to him." Therefore, unlike the situation in *Voege*, the New York statute both provides for the plaintiff's right to a fair appraisal and preserves his right to challenge the legality of the merger. Under these circumstances, no reason here exists for attempting to extend the purview of Section 10(b) of the Securities and Exchange Act beyond the decisions of this circuit or in seeking to rationalize "in connection with the purchase or sale of any security" to the situation here presented.

For the foregoing reasons, the plaintiff has not stated a cause of action under the Securities and Exchange Act and therefore pendent jurisdiction cannot be applied to his common law cause of action. Nor does the court have diversity jurisdiction under 28 U.S.C. §1332 as to his common law action. While diversity of citizenship exists between the plaintiff and Beneficial, the only defendant served, the complaint does not satisfy the $10,000 federal jurisdictional requirement. The damage claimed for all 624,870 shares of Class A stock is $1,700,000 or approximately $2.73 per share. Plaintiff's proportion of this claim, as a record holder of 100 Class A shares, would be $273, far below the $10,000 requirement.

This result is not changed by the fact that plaintiff sues on behalf of all Class A stockholders. Although class actions may be maintained pursuant to Rule 23(a)(3) in actions of this type, *Oppenheimer* v. *F. J. Young & Co.*,

144 F.2d 387 (2d Cir. 1944), the representative of the class in such a "spurious" class action must individually allege the jurisdictional amount and cannot aggregate the claims of the class. *Central Mexico Light & Power Co.* v. *Munch*, 116 F.2d 85 (2d Cir. 1940); 3 Moore, *Federal Practice*, ¶23.13 (2d ed. 1964).

Nor can plaintiff satisfy the jurisdictional amount by casting his suit as a derivative action on behalf of Crown. In *Oklahoma Gas Co.* v. *Oklahoma*, 273 U.S. 257 (1927), it was held that the law of the state of incorporation governed the right of a dissolved corporation to sue or be sued. Crown was a Delaware corporation and Delaware law provides only for the continuance of actions pending by or against a corporation subsequently merged. 8 Del. C. §261; compare, N.Y. Business Corp. Law, §906. The present action was not commenced until October 13, 1965, whereas the merger took place on September 30, 1965. Under these circumstances, the Delaware courts have held that a derivative suit may not be maintained on behalf of the merged corporation. *Braasch* v. *Goldschmidt*, 199 A.2d 760, 767 (Ct. of Chan. of Del. 1964).

For the reasons stated above, the court lacks jurisdiction of this action, and the complaint fails to state a cause of action on which relief can be granted. Defendant's motion to dismiss is granted.

It is so ordered.

Dated: New York, N. Y.
February 23, 1966.

/s/ DUDLEY B. BONSAL
U. S. D. J.

U.S. DISTRICT COURT
FILED
Feb 23 1966
11:45 AM
S. D. OF N. Y.